

Financial Management for Idaho Cities:

A Primer on Accounting, Financial Reporting and Internal Controls

Idaho State Controller's Office
Association of Idaho Cities

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Introduction

This primer is intended to assist you in improving financial management practices in your city, and is the result of a partnership between the Idaho State Controller's Office and the Association of Idaho Cities. The primer includes the following sections:

GAAP Accounting – How to Get There
GAAP Accounting – The New Reporting Model
GAAP Accounting – What's New and In Development
Internal Controls – Idaho's Management Control System
Fiscal Policies

Our intent is for the primer to be a working document for city elected officials and staff, with regular updates based on your feedback and new developments in financial management practices and principles. We hope you find this primer to be a valuable resource in your day-to-day efforts to serve Idaho's citizens.

Sincerely,

Keith Johnson
Idaho State Controller

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Generally Accepted Accounting Principles: How to Get There

This primer is intended to assist your city in producing financial statements in compliance with Generally Accepted Accounting Principles (GAAP) as defined by the pronouncements of the Governmental Accounting Standards Board (GASB). This summary will give you a basic understanding of governmental accounting principles.

Alphabet Soup—the Acronyms of Governmental Accounting

American Institute of Certified Public Accountants (AICPA): a national association of certified public accountants which establishes technical policies on financial reporting and auditing and also seeks to influence the development of standards by GASB and other organizations.

Comprehensive Annual Financial Report (CAFR): a financial report that encompasses all funds and component units of the government. The CAFR should contain (a) the basic financial statements and required supplementary information, (b) combining statements to support columns in the basic financial statements that aggregate information from more than one fund or component unit, and (c) individual fund statements as needed. The CAFR is the government's official annual report and should also contain introductory information, schedules necessary to demonstrate compliance with finance-related legal and contractual provisions, and statistical data.

Generally Accepted Accounting Principles (GAAP): the rules and procedures that serve as the norm for the fair presentation of financial statements.

Governmental Accounting Standards Board (GASB): the authoritative body for governmental accounting and financial reporting standards for federal, state and local governments.

Government Accounting, Auditing and Financial Reporting (GAAFR): the authoritative text on governmental accounting, auditing and financial reporting, published by the Government Finance Officers Association.

Government Finance Officers Association (GFOA): an association of public finance professionals that has played a major role in the development and promotion of generally accepted accounting principles for state and local governments.

Management Discussion and Analysis (MD&A): a component of required supplementary information used to introduce the basic financial statements and provide an analytical overview of the government's financial activities.

National Council on Governmental Accounting (NCGA): this organization served as the authoritative accounting and financial reporting standards body until the formation of GASB in 1984. The NCGA issued 7 statements and 11 interpretations that remain effective until superseded by GASB pronouncements.

Governmental Accounting Versus Private Sector Accounting

Governmental accounting differs significantly from accounting in the private sector. Businesses exist to make money, by providing goods or services to customers at the maximum price the market will bear (which must at least cover the cost of providing the good or service). Business transactions are voluntary, depending on a potential customer's need or desire for the goods or services being offered. Government services that are supported by user charges (such as water or sewer service) function in much the same way as private-sector businesses.

Most government activities, however, function quite differently than private-sector businesses. First, government services are not a means to an end (profit); rather, they are an end in themselves. The government's goal is to maximize service, not revenue. Second, for tax-supported activities, there is no direct relationship between the level of taxation and the services a taxpayer receives. Finally, participation in governmental activities is typically compulsory, at least from the viewpoint of the individual taxpayer.

GAAP Compliance

City officials are responsible for accounting for the appropriate use of city revenues and showing compliance with state laws and local ordinances restricting the expenditure of public funds. The best way to achieve both ends is by producing audited, GAAP-compliant financial reports. There are other reasons for local governments to become GAAP-compliant, including:

- allowing creditors to make sound lending decisions;
- providing information to oversight bodies;
- "opening up the books" for citizen review; and,
- giving decisionmakers another tool to manage the affairs of government.

Generally accepted accounting principles for federal, state and local governments are determined by the Governmental Accounting Standards Board (GASB), and are organized into a hierarchy of four levels.

- **Level 1 GAAP** includes GASB Statements and Interpretations, and statements and interpretations by the National Council of Governmental Accounting (NCGA), which is GASB's predecessor. GASB may incorporate other standards by reference, which are also accorded Level 1 GAAP status. For governmental business-type activities (such as water or sewer funds), private sector guidance issued prior to December 1, 1989 also has Level 1 status.
- **Level 2 GAAP** includes GASB technical bulletins, American Institute of Certified Public Accountants (AICPA) Audit Guides and Statements of Position.
- **Level 3 GAAP** includes AICPA Accounting Standards Executive Committee Practice Bulletins and Consensus Positions of GASB Emerging Issue Task Forces.
- **Level 4 GAAP** includes GASB Implementation Guides. In the absence of other authoritative sources, financial statement preparers are to follow widely recognized and prevalent practices.

Develop a Plan to get to GAAP Compliant Financial Statements

As with everything else in life, getting to GAAP-compliant financial statements takes planning, based on your city's size and the resources available. After outlining major tasks, you should estimate resources and set realistic target dates. If you are unable to obtain additional resources for the overall project, you may need to extend the timeframe of the plan. Major steps in getting to GAAP compliance are listed below:

<u>Objective</u>	<u>Goal Date of Completion</u>
Governmental Accounting Training	_____
Coordinate with Auditors	_____
Evaluate the Adequacy of Current Accounting System	_____
Classifying Fund Types	_____
Converting from Budget Basis to GAAP	_____
Consider Reporting for Outside Entities	_____
Drafting the Comprehensive Annual Financial Report	_____
Review GFOA Checklist	_____

Governmental Accounting Training

A variety of training resources are available for those interested in building the skills to produce GAAP-compliant financial statements. The Idaho chapter of the Association of Government Accountants holds a number of professional development events every year (www.agaidaho.org). The Government Finance Officer's Association (www.gfoa.org) also presents a number of excellent educational programs around the country every year.

Coordinate with Auditors

Your auditors should be involved from the outset of your effort to produce GAAP-compliant financial statements. Auditors can offer valuable perspective on classification of funds, reporting for outside entities, the presentation of the comprehensive annual financial report and many other issues.

Does Your Accounting System Work?

An accounting system for a very small city may consist of a hardbound ledger with a file drawer for bills, receipts, and statements. Converting from a cash basis to a GAAP-compliant set of financial statements may only entail adding a separate section to the ledger or perhaps using a spreadsheet application on a personal computer.

However, for those cities with accounting issues that are more complex, either a good spreadsheet application or computerized software accounting application is important. Off-the-shelf accounting systems are reasonably priced and should handle most issues faced by a small city. For larger cities, a customized software application may be desirable. If you are already operating with a customized application you may need to check with your software contact to verify if the current structure can produce GAAP-compliant financial statements and related tasks.

When contemplating system needs to meet the new GAAP reporting requirements (full-accrual reporting) requirements, consider if the system is to produce the actual reports. This is an important consideration because of the design of the new Statement of Activities. You may find that it makes sense to produce the financial statements in a spreadsheet application.

Determine Fund Types

A fund is an accounting entity with a self-balancing set of accounts. A single fund's balance sheet accounts can be presented on a balance sheet and assets will equal liabilities plus equity. Fund accounting is reflective of the fact that cities provide many different services, such as police, fire, water, sewer, streets, planning, and recreation. Different types of resources are used to pay for these services, including involuntary resources (such as property taxes) and voluntary resources (such as user fees). Cities must comply with a number of restrictions on the use of revenues. Some restrictions are imposed as a condition of receiving grant funds from the state or federal government. Other conditions are associated with particular resources managed by the city (such as pension funds), and additional limitations are imposed by city elected officials (such as a dedicated fund for street maintenance). Different accounting and reporting mechanisms are needed for different funds. The three main categories of funds are governmental, proprietary and fiduciary and there are a number of different types of funds within each category.

1. Governmental Funds:

- **General Fund:** General, unrestricted revenues of the city or revenues whose use is not restricted to any specific purpose, including property taxes and state shared revenues. The general fund includes city administration, police, fire, streets, planning, and parks and recreation.
- **Special Revenue Funds:** Used to account for revenue legally earmarked for a specific purpose.
- **Debt Service Funds:** Used to account for the accumulation of resources for and the payment of principal, interest and related costs of long-term debt.
- **Capital Projects Funds:** Used to account for financial resources for the acquisition of major capital facilities, other than those accounted for in proprietary or trust funds.
- **Permanent Fund:** Used to account for financial resources that are legally restricted to the extent that only earnings, and not the principal, may be used for supporting government programs.

2. Proprietary Funds:

- **Enterprise Funds:** Self-supporting funds used to support commercial-type enterprises financed by user fees, such as water and sewer service and garbage collection.
- **Internal Service Funds:** Revenues derived from transfers from one department of the city to another to account for services rendered, such as printing, utility billing, vehicle maintenance, and computer maintenance and assistance.

3. Fiduciary Funds:

- **Pension Trust Funds:** Funds established to receive and invest payments held in trust by government for its employees and to distribute benefits to eligible retirees.
- **Agency Funds:** Funds used to collect and temporarily hold money for a third party, often another unit of government.
- **Investment Trust Funds:** Funds used to report governmental external investment pools in separately issued reports and the external portion of these same pools when reported by the sponsoring government.

- **Private-Purpose Trust Funds:** Funds used to report all trust arrangements, other than those properly reported in pension trust funds or investment trust funds, under which principal and income benefit individuals, private organizations or other governments.

GFOA's *Governmental Accounting, Auditing, and Financial Reporting* (also known as the "Bluebook") is a good general reference for determining the classification of funds.

Develop Process for Conversion from Budget Basis to GAAP

City officials have a responsibility to comply with the annual budget, enacted as the appropriations ordinance, which sets a ceiling on the level of expenditures. Budgetary reporting is a way to demonstrate compliance with the budget by focusing on current revenues and expenditures. In contrast, financial reporting is concerned with the economic substance of transactions (i.e. the change in an entity's net assets). Budgetary reporting uses the cash basis of accounting—that is, transactions are recognized when money is received or expended. GAAP-compliant financial reporting relies on the accrual basis of accounting—that is, transactions are recognized as the cause of the change occurs, regardless of the timing of related cash flows.

Policies need to be established to ensure consistency in reporting, particularly in areas where there is considerable discretion. For example, the State of Arkansas recognizes the existence of 5 GAAP funds at the state level, while the State of Mississippi recognizes the existence of 1,380 GAAP funds at the state level. What works for Jerome may not work for Bliss. It is important that each city carefully craft the accounting policies and structure that is appropriate.

Consider Reporting Entity Issues

GAAP requires that governments look beyond the legal structures that define municipal government in order to create a financial reporting entity that reflects the accountability of city elected officials. In other words, the government's financial reports must include not only the city, but also any outside entities for which city officials are financially accountable (also known as a "component unit").

GASB Statements 14 and 39 detail the considerations necessary to determine the financial reporting entity. In addition, the *Bluebook* has a good discussion of this issue. City officials need to ask if the financial affairs of a cemetery district or perhaps a foundation are closely intermingled with those of the city. There are three specific tests for determining whether a legally separate entity is a component of the city's financial reporting entity:

- ✓ Does the city appoint a voting majority of the entity's governing board, and does the appointment process create an ongoing relationship between the city and the entity?
- ✓ Is the entity dependent on the city for financial resources?

- ✓ What is the likelihood that exclusion of the entity would result in misleading financial reporting?

Draft Comprehensive Annual Financial Report

After working through all of these issues you will be ready to prepare a draft set of financial statements. There are many tasks to work through when proofing your draft statements, including:

- ✓ Do the notes tie to the financial statements?
- ✓ Do the amounts reported in the transmittal letter and the management discussion and analysis (MD&A) tie to your notes and to your financial statements?
- ✓ Can you reconcile the government-wide (full accrual) statements to the fund statements?
- ✓ Do the fund statements that present fund information at a lower level tie to the fund statements that present information at a higher level?

Review GFOA Checklist

The Government Finance Officers Association certifies government financial statements; those statements that meet GFOA criteria are awarded Certificates of Excellence. The criteria for certification are available at GFOA's website (www.gfoa.org/). This checklist should be used to review your CAFR before it is finalized and sent for GFOA consideration. You should not expect to receive the Certificate of Excellence the first year. Generally, there are some flaws in your statements that will only be discovered after a comprehensive GFOA review. The second year is a more reasonable target for GFOA certification.

GAAP Accounting - The New Reporting Model

The Governmental Accounting Standards Board (GASB) issued Statement 34 in June 1999, establishing new requirements for the annual financial reports of state and local governments. Upon the issuance of Statement 34, all governmental accounting textbooks were out of date. The new reporting model totally restructured governmental accounting. GASB Chairman Tom Allen called Statement 34 “the most significant change in the history of governmental accounting. It represents a dramatic shift in the way state and local governments present financial information to the public.” The Idaho State Controller’s Office implemented Statement 34 in fiscal year 2002. Idaho’s Fiscal Year 2002 Comprehensive Annual Financial Report may be accessed online at www.sco.state.id.us by clicking on “Library,” then “Publications,” and finally, “Annual Financial Reports.” The CAFR will be useful to refer to as the various aspects of the new reporting model are discussed.

The Statement was developed to make annual reports easier to understand and more useful to the people who use governmental financial statements. The new Statement retains much of the existing information (emphasizing current activities) while additionally requiring the reporting of full accrual information (similar to private businesses), a management discussion of the financial statements, and reporting on the government’s infrastructure (such as roads and bridges).

GASB has identified accountability as the primary concern of governmental financial statements. The two components of accountability are *financial accountability* and *operational accountability*. According the GFOA *Bluebook*, financial accountability is “the responsibility of governments to justify that their actions in the current period have complied with public decisions concerning the raising and spending of public moneys...” *Operational accountability* is “governments’ responsibility to report the extent to which they have met their operating objectives efficiently and effectively...” While the fund financial statements serve the purpose of *financial accountability*, they did not provide *operational accountability*. GASB has argued that a broader lens is required to bring *operational accountability* into focus. The two sets of statements are not conflicting, but rather serve to complement one another.

Some things to keep in mind:

- Develop an implementation plan.
- Identify current reporting deficiencies.
- Establish capital asset policies.
- Prepare pro forma statements.
- Work closely with your auditors!
- You will not have to change the way you budget.
- The account groups (General Fixed Asset and General Long-Term Obligations) are eliminated!
- For the most part the current financial statements will continue to be presented using the same basis of accounting. Fiduciary funds that had been reported as expendable or nonexpendable trust might use full accrual or modified accrual.
- The use of estimates are appropriate, just remember to be logical and consistent in their application and keep materiality in mind.
- Most of the financial reporting you have done in the past will only change marginally.
- A standard comment of governments that have implemented the new model is "Infrastructure wasn't as tough as we thought it would be!"

Infrastructure

A new requirement of Statement 34 is reporting of infrastructure. Infrastructure assets are long-lived capital assets that normally are stationary in nature and can be preserved for a significantly greater number of years than most capital assets (roads, bridges, water and sewer systems, etc.).

- Identify all potential networks (e.g., water system) or subsystems (e.g., water treatment plant) of infrastructure assets.
- Determine the networks or subsystems that exceed the major threshold criteria: Networks – greater than 10% of fiscal year 1999 fixed assets; Subsystems – greater than 5% of fiscal year 1999 fixed assets.

- Determine the method used to report infrastructure assets. You may either report them using the traditional depreciation approach or the modified approach. Under the depreciation approach the value of the assets are written down in the same manner as they would be for any capital asset. The State of Idaho chose to use the depreciation approach for its bridges because the bridges are totally replaced after a certain point. Under the modified approach the value of the asset is not depreciated because it is anticipated that the asset will continue to be used and maintained for the foreseeable future. The State of Idaho chose to use the modified approach for its roads.
- The use of the modified approach requires additional disclosure in the Required Supplemental Information section. This disclosure will provide valuable information to the readers (please see Idaho's 2002 CAFR, pages 81 – 82).
- If the government chooses to use the modified approach, condition levels for the infrastructure network or subsystem must be decided upon and funded into the future. This choice requires a commitment from management that should be carefully thought out.

The basic requirements for infrastructure are found in paragraph 11 of Statement 34.

Management Discussion and Analysis

The Management Discussion and Analysis (MD&A) is some of the new information debuting as a result of Statement 34. The MD&A will introduce the basic financial statements and provide an analytical overview of the government's financial activities. The financial managers of governments are knowledgeable about the transactions, events, and conditions that are reflected in the financial statements and that are contained in the government's financial policies. Those financial managers will share their insights in a required MD&A that gives readers an objective and easily readable analysis of the government's financial performance for the year.

The MD&A provides an analysis of the government's overall financial position and results of the previous year's operations to assist the readers in assessing whether the government's finances have improved or deteriorated. The analysis also includes a comparison of the current year to the prior year based on government-wide financial information about assets, liabilities, revenues, and expenses. In addition, the analysis explains significant variations in fund-based financial results and budgetary information, and will describe capital asset and long-term debt activity during the year. The MD&A concludes with a description of currently known facts, decisions, or conditions that are expected to have a significant effect on the government's future financial position and operations.

The basic requirements for an MD&A are found in paragraphs 18-26 of Statement 34.

Basic Financial Statements

The basic financial statements include the traditional fund statements, the new government-wide statements, and the notes to the financial statements.

Formerly, annual reports divided financial information among a variety of categories or “funds.” These funds were established by governing boards to show restrictions on the use of resources or to measure (in the short-term) the revenues and expenditures from particular activities. GASB has continued to use fund statements because statement users continue to assess government accountability according to compliance with the adopted budget and other rules and regulations. Fund-based statements for governmental activities (generally, those supported by tax revenues) will continue to report the flow of current financial resources, and will still show the short-term performance of individual funds.

There are three basic fund types: governmental, proprietary, and fiduciary. Governmental funds track the basic activities of government. Proprietary funds report activities generally financed and operated like a private business. Fiduciary funds report assets that are held for others and cannot be used to support the government’s own programs.

The traditional fund statements have new Statement 34 features and requirements:

- Each of the fund statements will report separate columns for the general fund and other major governmental and proprietary funds. Major funds are those whose revenues, expenditures/expenses, assets or liabilities are at least 10 percent of the total for their fund category or type (governmental or enterprise) and at least 5 percent of the aggregate amount for all governmental and enterprise funds. Any other fund may be reported as a major fund, if it is considered of high importance. Nonmajor funds will be aggregated into a separate column.
- Proprietary fund balance sheets must be presented in a “classified” format. This means that current and noncurrent assets and liabilities must be separately displayed.
- Proprietary cash flow statements must be prepared using the direct approach.
- Permanent funds are a new governmental fund type classification. Permanent funds report resources legally restricted so that only earnings, and not their principal, may be used to finance activities.

The basic requirements for fund financial statements are found in paragraphs 63-112 of Statement 34.

For the first time the annual report will include financial statements prepared using full accrual accounting for all of the government's activities. This approach includes not just current assets and liabilities but also capital assets and long-term liabilities. Accrual accounting also reports all of the revenues and costs of providing services each year, not just those received during the year or shortly thereafter. Full accrual accounting will help readers answer the following important questions:

- Are current citizens paying for the services they receive in the current year, or are the costs of services shifted to citizens in the future?
- Has the government's financial position improved or deteriorated as a result of the year's operations?
- To what extent has the government invested in capital assets, including infrastructure?
- To what extent are programs self-supporting, and to what extent do the programs rely upon general tax revenues?
- What net assets are available to the government for discretionary funding?
- How quickly are capital assets being used up? This allows readers to plan for the replacement of those resources.

In short, the new government-wide statements should give government officials a new way to demonstrate their long-term stewardship of the community.

The basic requirements for the government wide financial statements are found in paragraphs 12-62 of Statement 34.

The note disclosures are the conclusion of the basic financial statements. The note disclosures have not radically changed with the new reporting model; however, there was a change in focus with the advent of the new government-wide statements. Formerly, the notes focused on the fund statements. Now, the focus of the notes is on the government-wide statements. Those who have already produced GAAP-compliant statements will have to take into account the changes to the summary of significant accounting policies, capital asset, and long-term liability notes. The account groups are no longer reported and governmental funds are now incorporating capital assets and long-term liabilities in the government-wide statements.

The basic requirements for note disclosures are found in paragraphs 113-123 of GASB Statement 34, National Council on Governmental Accounting Interpretation 6, and the individual statements that require note disclosures. The following documents are good references that simplify the compilation of a governments notes:

- *Governmental Accounting and Auditing Disclosure Manual*, Warren, Gorham & Lamont, NY, NY, 1-800-431-9025;
- *Governmental Accounting and Financial Reporting Standards*, GASB publication that may be ordered through their website (www.gasb.org/).

Required Supplementary Information

The Required Supplementary Information (RSI) follows the notes. The big change to RSI is the inclusion of infrastructure information for those governments that have adopted the modified approach. An additional change is the new option to report on the budgetary basis of accounting. The other RSI disclosures pertain to pensions, and are not new requirements.

The basic requirements for the RSI disclosures are found in paragraphs 129-133 of GASB Statement 34, and paragraph 22 of GASB Statement 27.

GAAP Accounting - What's New and in Development

New Statements

GASB 36 - Non-exchange Revenues

GASB Statement 36 was issued in April 2000 and is effective for periods beginning after June 15, 2000. This statement provides for symmetrical accounting treatment of certain shared revenues and supercedes paragraph 28 of Statement 33 (*Accounting and Financial Reporting for Nonexchange Transactions*).

Statement 33 details the timing of recognition of nonexchange transactions. In a nonexchange transaction, a government gives or receives value without directly receiving or giving up essentially equal values (for example, most taxes, grants, and private donations). Statement 36 clarified the treatment of governmental shared revenues. Prior to the issuance of Statement 36, recipients of shared revenues could account for these monies differently than the provider government. Statement 36 eliminates that timing difference by requiring recipient governments to account for shared revenues in the same manner as provider governments.

For examples and comprehensive explanations see Statement 33, paragraphs 70, 83-85, and Appendix C, and Statement 36 Appendix C.

GASB 37 - Basic Financial Statements

This is a housekeeping effort by GASB, clarifying some aspects of Statement 34 implementation. Implementation of this Statement should be simultaneous with Statement 34.

1. Escheat property, that is, property that reverts to a government in the absence of legal claimants or heirs, formerly reported in an expendable trust fund would now be accounted for in a private purpose trust fund (expendable trust and nonexpendable trust funds were eliminated by Statement 34).
2. Paragraph 11 in Statement 34 was originally phrased as a minimal reporting requirement for the MD&A. Statement 37 has clarified that wording so that paragraph 11 is presented as the comprehensive listing of what may be discussed in the MD&A.
3. Capitalization of construction period interest charges is not required for governmental funds. The original wording in Statement 34 mandated the capitalization of interest charges for governmental funds.

4. The Statement provided the clarification that if a government changed its infrastructure reporting from depreciation to the modified approach, the change would be handled as a change in accounting estimate. This removed the requirement for governments to restate prior period amounts (as would be required in a change of accounting principle).

This Statement (called an Omnibus Statement) is very readable. The Basis for Conclusions section (paragraphs 23 through 69) provide excellent background.

GASB 38 - Note Disclosures

Before the implementation of this Standard, note disclosures were seen as discrete, viewed primarily in relation to the individual pronouncement of which they were a part. In order to address this lack of cohesiveness, GASB has reconsidered disclosure requirements as a single body of standards. Implementation of this Statement should be simultaneous with Statement 34. This Statement is a result of that reconsideration and specifically applies to:

1. The summary of significant accounting policies.
2. Actions taken to address violations of significant finance-related legal and contractual provisions.
3. Debt and lease obligations.
4. Disaggregation of receivable and payable balances.
5. Interfund transfers and balances.

Statement 38 contains several useful note illustrations in Appendix C, while the main portion of the actual standard is compactly summarized in paragraphs 1 through 15.

GASB 39 - Reporting Entity

This Statement expands the criteria established in Statement 14, which provided guidance for determining if an organization is part of the reporting unit. This will aid governments that have not previously considered if an affiliated organization is a component unit of the primary government. Under the new Statement, entities that are legally separate, tax-exempt organizations affiliated with the primary government and that meet each of three criteria would be discretely presented within the primary government's financial report. The three criteria are:

1. The financial resources of the separate organization entirely, or almost entirely, directly benefit the primary government, its component units, or its constituents.

2. The primary government or its component units are entitled to, or can otherwise access, a majority of the financial resources of the separate organization.
3. The financial resources that the specific primary government is entitled to, or can otherwise access, are significant to the primary government.

Statement 39 should be carefully studied in its entirety before deciding upon the inclusion or exclusion of a separate entity. Remember to consider materiality.

GASB 40 – Deposit and Investment Risk Disclosures

GASB issued Statement 40 on March 27, 2003. The Statement is applicable for periods beginning after June 15, 2004. The statement requires additional disclosures related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. This statement also amends GASB Statement 3, Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements.

Exposure Drafts

Post Employment Benefits

GASB has issued two exposure drafts and a plain language supplement relating to accounting for post employment benefits (such as retiree health care benefits). These new standards will require employers to account today for the costs of future benefits to be provided to retired employees. The majority of post employment benefits are not considered costs to employers until they are paid on behalf of retirees. In essence, these new standards apply the same theory to post-employment benefits that GASB applied to pension benefits in GASB Statements 25, 26 and 27.

Capital Asset Impairment

This exposure draft would require governments to report the effects of capital asset impairment in the financial statements when they occur. This change will reflect the reduction in service capacity that results from impairment of significant governmental assets.

Budgetary Comparison - Perspective Differences - Amends 34

This Statement amends the recently issued Statement 34, by having governments present budgetary comparison schedules as required supplementary information based on the fund, organization, or program structure that the government uses for its legally adopted budget. Some governments do not budget using the same fund structure used for financial reporting. The use of non-GAAP fund structure for budgeting may prevent a government from presenting budgetary information for the general fund and major special revenue funds as required by Statement 34.

On Future Technical Agenda

Derivatives

Derivative products are financial instruments created from or whose value depends on the value of one or more underlying assets or indexes of asset values. GASB is currently working on establishing a standard that will provide reporting guidance for derivatives and hedges. GASB Board discussions on project issues are scheduled to begin in the second quarter of 2003, and an exposure draft is planned for the second quarter of 2004.

Economic Condition Reporting

Economic condition includes:

1. Financial position. The status of a government's asset liability and net asset accounts.
2. Fiscal capacity. A government's ongoing ability and willingness to raise revenues, incur debt, and meet its financial obligations as they come due.
3. Service capacity. A government's ongoing ability and willingness to supply the capital and human resources needed to provide services.

Enhancements to CAFRs, to reflect a government's economic condition, are being considered by GASB. The changes would probably occur in the statistical section of the financial reports. The statistical section may include analytical comments, explanations, descriptions, and conceptual explanations. Currently, the statistical sections are primarily charts and tables with a minimum of narrative.

Pollution Remediation Obligations

GASB is researching the implications of having state and local governments report liabilities relating to environmental cleanup obligations for superfund and nonsuperfund sites (mostly matching obligations and obligations where the government is a potentially responsible party). GASB is also considering having the costs of pollution prevention compliance and asset retirement obligations as part of the project.

Internal Controls - Idaho's Management Control System

Internal Controls

Why Are They Important?

Now more than ever, citizens are demanding that government officials be accountable for their stewardship of public funds. This requires that managers use public funds as effectively and efficiently as possible, in full compliance with laws, rules, and regulations. Internal controls are practical techniques used by management to achieve their objectives and to meet their responsibilities. A management control system gives the public more confidence that the city is achieving its goals and objectives in accordance with rules and regulations.

Statewide Management Control System

The statewide Management Control System (MCS) was developed in 1994 to provide managers in the State of Idaho with tools necessary to evaluate and strengthen internal controls within their agencies. The System was structured after the report of the Committee of Sponsoring Organizations of the Treadway Commission, entitled *Internal Control—Integrated Framework* (COSO), which has become a national standard for both public and private sector organizations. The COSO provides guidance for a good internal control system and reduces the risk of fraudulent activities within an organization. If a government builds the components of a management control system into its planning activities as well as its daily activities, officials and staff are more likely to avoid unnecessary costs, make quick responses as needs arise, and adapt to decreasing resources and changing political and economic climates. The five components of the State's Management Control System include:

- 1. Control Environment**—an organization's people, including their individual attributes and the environment in which they operate. The control environment is the foundation for all other components of internal control. Until an organization has competent, trustworthy people and strong leadership, the other areas will be ineffective. Following are the points of focus for an effective control environment:
 - Integrity and ethical values—employees are likely to develop the same attitudes about what's right and wrong as those shown by top management. Ethical values need to be clearly communicated and modeled.
 - Commitment to competence—management must analyze what knowledge and skills are needed by employees to perform their jobs adequately, hire competent people, and maintain competency through training.

- Oversight and governance—oversight and governance groups set standards and specify procedures for the operation of government programs. They play a role in ensuring an adequate management control system.
- Management philosophy and operating style—management's philosophy and operating style affect the way the government is managed. Government officials determine what kinds of risks will be acceptable.
- Organizational structure—provides a framework for achieving entity-wide objectives. Each government needs to establish a structure appropriate for its mission. The larger the government, the more highly structured and formal its reporting lines will be.
- Assignment of authority and responsibility—degree to which employees and departments are encouraged to use initiative in addressing issues and solving problems. The effectiveness of the control environment is greatly enhanced when employees recognize they will be held accountable for their performance. Authority should be delegated to the individuals who are closest to everyday business decisions.
- Human resource policies and practices—practices relating to hiring, orientation, training, evaluation, counseling, promotion and compensation send messages to employees regarding management's expected levels of integrity, ethical behavior, and competence (i.e., standards for hiring the most qualified individuals with emphasis on educational background, prior work experience, and evidence of integrity demonstrate a government's commitment to competent and trustworthy people).

2. Risk Assessment—a government's awareness of its objectives and the risks it faces in not achieving them, along with the mechanisms it establishes to identify, analyze, and manage the risks. Following are the points of focus for effective risk assessment:

- Entity-wide objectives—objectives relating to achievement of a government's mission. These objectives pertain to effectiveness and efficiency of operations, including performance and financial goals and safeguarding resources against loss. These objectives must be communicated to all employees. If employees are unaware of the objectives, they may be working against them.
- Activity-level objectives—managers should establish activity-level objectives for the areas for which they are responsible. These objectives must be linked to entity-wide objectives.

- Understanding risks—identifying and analyzing risk is an ongoing process. Management must focus on risks at all levels of the government (both internal and external) and take the necessary actions to manage them. Risk analysis involves a careful, rational process of estimating the significance of a risk, assessing the likelihood of its occurrence, and considering actions to manage it.
 - Managing change—internal controls that are effective under one set of conditions will not necessarily be effective under another. Changes in conditions must be identified and actions must be taken to reduce unpleasant surprises (i.e., when change involves employees, communicate why change is necessary and involve employees in the process).
3. **Control Activities**—policies and procedures that the government establishes and executes to help ensure that it effectively meets its objectives and reduces the risks that result in failure of objectives.
4. **Information and Communication**—the processes and structures enabling officials and staff to capture and exchange information necessary to conduct and manage operations.
- Information—the result of analysis, evaluation, and synthesis of available data for influencing management activities. Pertinent information must be identified, captured, and communicated to appropriate personnel on a timely basis. The quality of information influences the quality of decisions.
 - Communication—the process of disseminating and utilizing information. Communication is the process of *mutually* understanding information. Communication must travel upward, downward, and laterally in any organization.
5. **Monitoring**—the way a government monitors its processes and modifies them to meet changing conditions. Monitoring assesses the quality and effectiveness of the controls. Internal control systems will deteriorate over time unless maintained by management.
- Ongoing monitoring—ongoing assessment of the process so an organization knows how it is doing. Monitoring ensures that internal control continues to operate effectively. Ongoing monitoring procedures are built into the normal operative activities (i.e. reconciliation of financial reports and systems).

- Separate evaluations—formal evaluation of the internal control system at a specific point in time. The evaluation can be conducted by management, auditors, or specialized groups. The evaluation process and scope need to be well defined, the methodology needs to be agreed upon, and the evaluation process and results need to be documented. An action plan for implementing needed improvements should be developed.
- Reporting strengths and weaknesses—providing information on internal control deficiencies to the appropriate party is critical to an effective internal control system. This gives management the opportunity to strengthen the system.

The State of Idaho's Management Control System can be found at www.sco.state.id.us. by clicking on "Library" and then "Manuals & Resources."

Fiscal Policies

Idaho's Fiscal Policy Manual

Background

The evolution defining governmental accounting principles was formalized in 1968 with the National Council on Governmental Accounting's (NCGA) publication entitled *Governmental Accounting, Auditing, and Financial Reporting* (GAAFR). The accounting principles outlined in GAAFR received wide acceptance by governmental accountants, finance officers, and other officials of governments, as well as independent practicing accountants. In 1979, NCGA issued *NCGA Statement No. 1*, which essentially restated the principles outlined in the 1968 GAAFR with minor revisions. In April 1984, the Governmental Accounting Standards Board (GASB) was formed under the auspices of the Financial Accounting Foundation to become the successor organization to NCGA. GASB has issued several Statements and continues to promulgate GAAP for financial accounting and reporting by state and local governments.

Fiscal Policy Advisory Committee

The Fiscal Policy Advisory Committee (FPAC) was established to facilitate Idaho's state government accounting practices to adhere to GAAP. The mission of the FPAC is to assist the State Controller in providing financial leadership to ensure accountability for the use of public resources. The FPAC goals are to establish uniform accounting and reporting standards and guidelines for all state agencies. The FPAC has determined the following criteria to be used for developing and evaluating policies—fiscal policies should:

- Be simple, consistent and clearly establish accountability.
- Identify and assist in meeting the needs of state agencies.
- Assist state agencies and other decisionmakers in better managing and reporting the fiscal affairs of the State of Idaho.
- Assist in issuing GAAP-compliant statewide financial statements that are available for an annual audit with an unqualified opinion.
- Help ensure internal control procedures are in place for sound financial management.

Current FPAC policies State Controller's website (www.sco.state.id.us) by clicking on "Libraries," then "Policies," then "Fiscal Policy Manual."

Travel Policy

The State Controller's Office has well established travel policies that conform to State laws and sound internal control practices.

Some basic thoughts to keep in mind when writing or revising travel policies include:

- All reimbursable travel must be properly authorized;
- The travel must actually occur;
- The travel must be essential to achieving the goals or fulfilling the responsibility of a particular department; and,
- The travel must be conducted in the most economical and practical manner.

The policy may be found at the State Controller's Office website (www.sco.state.id.us) by clicking on "Libraries," then "Policies," then "Travel Policy."

Moving Policy

Another possible pitfall for governments concerns the administration of the moving policy. Sound policies that are established in advance and are consistently followed will ensure equitable treatment of employees and protect the government from unwise or poorly thought out spending decisions.

In order to remain competitive in the employment market and attract a competent workforce, it may be necessary for Idaho cities to pay for moving costs of new employees. The State Controller's Office has established a comprehensive moving policy, which incorporates IRS considerations, applicable State law, and reasonable consideration towards recruitment and retention. The policy may be found at the State Controller's Office website (www.sco.state.id.us) by clicking on "Libraries," then "Policies," then "Moving Policy."

Purchasing and Procurement Issues

As with other areas of internal control, purchasing and procurement issues require consistent, understandable policies. The potential for mistakes has been compounded with the advent of the "P-Card", which is basically a credit card. The P-Card represents efficiencies in practice, partially because traditional constraints have been loosened over purchasing practices. It is incumbent upon cities to ensure that this loosening of traditional purchasing controls does not end up costing organizations more than the efficiencies gained by instituting the "P-Card."

The internal control considerations would be similar to that of travel policy. Any purchases must:

- Be authorized;
- Be essential to achieving the goals of the organization;
- Be economical and practical in nature; and,
- Be monitored (both before and after the fact) to ensure compliance with established policy/procedure.

The State Controller's Office (through the FPAC) is currently drafting a new policy incorporating P-Card purchasing.